

TESTIMONY  
BEFORE THE  
**COMMITTEE ON FINANCE**  
**UNITED STATES SENATE**

17 July 2002  
10:00 A.M.

Mr. Chairman and Members:

I am Ray Barnhart, a former Administrator of the Federal Highway Administration during the Reagan years, a resident of Texas, and a man who is genuinely grateful to you today for holding this hearing.

Even though fuel tax theft was shown to be a major problem seventeen years ago, it continues to siphon billions of dollars from our federal and state transportation programs.

A very brief re-cap of the situation. You'll recall that motor fuel taxes weren't worth stealing until Congress, twenty years ago, enacted the '82 federal highway bill. For the first time in 23 years federal fuel excise taxes were increased, and they were increased dramatically: the gasoline tax was more than doubled, from 4¢ per gallon to 9¢, and the diesel tax almost quadrupled, from 4¢ to 15 ¢ per gallon. The ink had hardly dried on that law when organized crime moved into the fuel distribution business, for it immediately saw that it could reap literally billions of dollars by stealing those taxes!

Since so few dollars were involved when the taxes were only 4¢ a gallon, collecting those taxes was low on the priority list of federal and state revenue officials: they had bigger challenges to face with their limited budgets, such as ensuring the collection of the tens of billions of dollars of income taxes. Why fret over penny-ante problems?

At that time anyone could become a motor fuel distributor: just fill out a simple form, called a 637, stating you were in the fuel business, and promising – on your honor – to faithfully remit to the government treasuries the fuel taxes you'd collect on the governments' behalf from the service stations when you sold them the fuel. Accordingly, the Mafia-types immediately took advantage of the situation and implemented a number of schemes whereby they would keep those taxes for themselves, and with little danger of being caught in the process. Some of those tax schemes are briefly described on page 5 of the kpmg Consulting analysis.

In 1985, as FHWA Administrator I was shocked to learn how many Trust Fund dollars Treasury estimated we'd be able to distribute to the state departments of transportation the ensuing year. The tremendous revenue gain we'd anticipated from the '82 highway bill tax increases hadn't materialized! A review of the possible explanations led to but one conclusion: organized crime had entered the fuel distribution business, big time! I

asserted publicly that criminal enterprises were stealing as much as \$ 1.7 billion dollars annually in federal fuel taxes, and that state governments were losing a comparable amount.

Subsequently, to close loopholes in the tax collection procedures, Congress moved the point at which the federal gasoline tax was levied from the distributor level to the terminal rack, which is one step removed from the refinery. This is where the fuel “breaks bulk” and one can determine if the fuel is to be used for a taxable or a tax-exempt purpose. Not surprisingly, the mob then curtailed its gas tax scams and switched to diesel fuel scams. To cope with this new fraud scheme, Congress then required that diesel fuel be taxed at the terminal rack as was gasoline. The first year after that change became effective Trust Fund revenue increased \$ 1.32 billion.

Now that government had gotten serious about collecting gasoline and diesel taxes, the mob then developed scams involving home heating fuel. There are two major differences between home heating fuel and diesel to power trucks: (1) some additives, primarily for brand identification; and (2) an average of more than 40¢ per gallon in federal and state taxes. The crooks began bootlegging home heating fuel and selling it to truck stops as diesel, but keeping the taxes for themselves. To show how rewarding this type scam can be, one mob family in New Jersey was finally busted in the mid ‘90s. It owned 4 terminals that allegedly handled only home heating fuel for the Northeast. It also happened to own 7 truck stops in the state of Virginia. When after several years authorities finally had a solid case, they seized the 4 terminals, the 7 trucks stops - - and 57 tanker trucks. There was a steady stream of these trucks, each hauling 8,000 to 10,000 gallons of home heating fuel from New Jersey, and selling it as diesel fuel across state borders, 300 miles away in Virginia. A dishonest operator could – and still can – net as much as \$ 4,000.00 by stealing the taxes due on a single truckload of fuel!

We’ve made much progress in coping with fuel tax theft during the past decade, but because of continuing weaknesses in our tax collection systems the problem is still massive. The fraud is multi-faceted, it occurs all across the nation and, while I can’t document it because records are so incomplete, I’ll stake my reputation on this statement: each year it means that billions of dollars are lost to federal and state transportation programs!

If you should think that’s a reckless assertion, let me buttress my argument by briefly discussing just one more scheme of the many that exist.

You’ve been given a “Motor Fuel Excise Tax Revenue Leakage Analysis” that highlights some of the details regarding aviation jet fuel (starting on page 8 of the analysis). Additionally, you have a graph in color that dramatically shows what has transpired concerning jet fuel since the tragedies of September 11.

Following that frightful day, airline travel plummeted. Yet according to the Bureau of Transportation Statistics, as you can see from the graph, **through May of this year the commercial airlines actually used an average of more than 300 million gallons of jet**

**fuel LESS per month than the amount of fuel allegedly supplied to them! You can see from the data accompanying the graph that a year ago, in March of 2001 – long before chaos hit the airline industry – even then the amount of jet fuel supposedly supplied to them was 317 million gallons MORE than what they reported using. Jet fuel scams, now becoming evident because of 9-11, have been on-going for years!**

Where did that fuel go? I'm convinced that most of it, at least, ended up being bootlegged to truck stops and sold as diesel motor fuel. And without remitting the appropriate taxes to government agencies! Since it thus displaced regular taxable diesel fuel, the tax loss from jet fuel could amount to \$ 160 million per month, dollars that should have gone to fund vital transportation programs.

How is this possible? Because while Congress has required that gasoline and diesel fuels be taxed at the terminal rack, it excluded aviation jet fuel from that provision. Like in the old days with gasoline and diesel taxes, fill out a form 637H, promise on your honor that you'll remit to Treasury any taxes on the fuel that you collect, and you, too, can become a dealer in jet fuel! If you cheat, beware! An overworked IRS agent may in a year or so get around to auditing your books!

Because aviation fuel is exempt from taxation at the terminal rack, organized crime continues to have free reign. I plead with you: revise the IRS Tax Code to close loopholes that facilitate tax theft, and **MOVE THE INCIDENCE OF THE AVIATION JET FUEL TAX TO THE TERMINAL RACK!**

Let me make this clear. In no way do I suggest that the major oil refiners, the vast majority of fuel distributors, or the airlines are parties to stealing taxes! There are, however, extremely clever Mafia-types and other dishonest individuals who grasp every opportunity to make a dishonest buck. Their scams can be stopped only if the Congress will enact meaningful laws and see that they're enforced.

Aviation fuel is especially vulnerable to tax cheats, much more so than scams involving gasoline, diesel, and home heating fuel. Why? Because with but a few exceptions, the burden of auditing and enforcing tax laws pertaining to jet fuel falls almost entirely on the U.S. Treasury agents!

Unlike on gasoline and diesel, the taxes state governments impose on jet fuel are relatively insignificant – if they exist at all. My state of Texas, for instance, with three major airlines (Continental, Southwest, and American), doesn't even levy a state tax on jet fuel; Montana has a 4¢ tax; Iowa taxes commercial jet at 3¢; New Jersey 2¢; California 1¢; etc. As a result, the revenue agencies in those states focus little attention on jet fuel auditing because the cost of doing so can't be justified by the dollars returned. Accordingly, it is most often left to federal officials to ensure the integrity of the tax collection process. The fundamental question is, are the feds equipped to cope with this massive undertaking?

Judge for yourself: there are approximately 140 federal fuel compliance officers in the entire nation who not only must ride herd on some 1,500 terminals that handle tens-of-billions of gallons of fuels, but also do on-road checks. Then there are an additional 300 audit-types that check thousands of individual companies, but those folks have to monitor not only motor fuels, but 44 other excise taxes as well.

And here's another of my major concerns. I understand through the grapevine that this IRS Division may be subject to a TWENTY-PERCENT REDUCTION in the coming fiscal year! "Hallelujah", the mob must be shouting, "another miniature Enron!"

Please do NOT allow that to happen. This IRS Division MUST be adequately financed if we are to put an end to these multi-billion dollar scams. I realize that it's popular with the public to damn tax collectors, but darn it, they're absolutely critical to the functioning of the country and to ensuring the integrity of our tax system. Additionally, two new and innovative programs, ExFIRS and ExSTARS, that have for months been under development, are now at the point of implementation. When that occurs, for the very first time it will be possible to determine how much fuel of each type will be sold in particular states. Because this knowledge is essential to getting tax theft under control, those programs must not be scuttled under the guise of "saving money." It would have the exact opposite result! I dare say that some of the federal initiatives that have been developed so far to fight fuel tax theft are among the most cost-effective in the history of tax enforcement, one of which returned \$ 27.00 for each dollar spent.

Thus far we have but touched the tip of the tax evasion problems. We haven't even discussed the lack of control over fuel imports and supposed exports! Billions of gallons of fuel are imported and moved throughout the country by ships and barges, as well as by trucks moving across our borders. Gaps a mile wide! There are numerous federal agencies involved in those maritime shipments, each collecting data of one kind or another. But is there an effective way to ensure that any taxes due on those fuels are actually paid to the proper authority? There are thousands of barge shipments each year, with each barge handling anywhere between 400,000 gallons to one million gallons of fuel. As near as I can tell, the collecting of data is the end in itself, and with little or no coordination between the diverse authorities.

Which brings up another significant issue to conclude my testimony. Just as the FBI and CIA failed to communicate pre-9-11, in many instances because they were precluded by laws from doing so, in the same way federal authorities in the various agencies involved in motor fuel tax enforcement often cannot exchange information on corrupt individuals and organizations between themselves or with their state counterparts. It's appalling to hear a federal law enforcement person in one agency tell an agent from another comparable agency, when a particular crook's activity arises in conversation, that "we cannot discuss this issue." Or to have that fed assert that he cannot share information with a state law enforcement official about a known crook who has moved into the state and started operations there. Although I'm not a lawyer, I do recognize that problems of jurisdiction are complicated and must be handled delicately. Nonetheless, barriers that

prevent authorities from exchanging important information on illicit activities must be eliminated wherever possible.

Thank you, most sincerely, for the opportunity to discuss these important issues. And they are exceedingly important. The entire highway community in this nation .... the state DOTs, contractors, and suppliers, are up in arms over the proposed reduction in federal highway funding due to RABA. I'm convinced that at least half of that RABA shortfall is due to one thing: motor fuel tax theft, fuel taxes that don't find their way into the Trust Fund. The problem can readily be resolved IF you will give us the means to do so. Revising the IRS Tax Code, closing loopholes, and moving the aviation jet fuel tax to the terminal rack will be a major help. Once that's accomplished, or better yet simultaneously, I hope we'll turn our attention to accounting for the hundreds of millions of gallons of fuel that are imported into our country and that should be subject to our highway taxes.

One final statement, hopefully to generate future discussion and action. A few states have aggressively attacked the problem of their state fuel taxes being stolen. But despite the documented results achieved thus far with federal fuel taxes, where billions of dollars have been re-directed to the Federal Highway Trust Fund rather than going to the coffers of criminals, most states continue to give this situation short shrift. Michigan emulated the federal procedure of levying the state tax at the terminal rack and increased its revenue \$ 38 million a year; Wisconsin gained \$ 30 million, as did Oklahoma, and California increased its state fuel tax revenue by \$ 65 million. My state of Texas, I regret to say, but I proclaim it FOR THE RECORD, is among the majority of states whose efforts in this regard are deplorable. Perhaps, through this Hearing, those states will finally gut up to their responsibilities.

Thank you.